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The Promoter and his Methods

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THIS IS TO CERTIFY THAT THE THESIS PREPARED UNDER MY SUPERVISION BY

Mr. F. R. Viley

ENTITLED

The Promoter and His Methods

IS APPROVED BY ME AS FULFILLING THIS PART OF THE REQUIREMENTS FOR THE DEGREE

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CONTENTS.

| | |
|---|------|
| Chapter I. | Page |
| The Development of the Field for the Promoter. | 1 |
| Chapter II | |
| Promotion of the Tin Plate Company | 7 |
| " " " United States Shipbuilding Company. | 12 |
| " " " International Mercantile Marine. | 21 |
| " " " United States Steel Corporation. | 29 |
| " " " Consolidated Tobacco Company. | 38 |
| " " " Northern Securities Company. | 42 |
| " " " Rock Island Company. | 49 |
| Chapter III. | |
| Conclusion. | 56 |

CHAPTER 1.

The Development of the Field for the Promoter.

The amount of capital invested in manufactures in the United States is constantly on the increase. At present the amount invested is about ten billion dollars as against twelve billion dollars invested in transportation and twenty-two billion in agricultural pursuits. The amounts invested in various manufacturing industries varies widely, from the iron and steel industry, with its investment of nearly two billion dollars, down to the lace industry with a total invested capital of less than a million. However great or however small the industry there has been in the past decade one uniform tendency in all manufacturing lines, the tendency to consolidate. One might say a tendency away from competition. Possibly we find stronger evidences of this tendency somewhat earlier in the transportation than in the manufacturing business. Thus we have the great Chicago-Omaha pool formed in 1870 between the three lines connecting those cities. However, it was only a question of time until pools and pooling arrangements became quite common in manufacturing circles. Being as they were a division of territory, or of profits, or at least an understanding among several manufacturers whereby profit was to accrue to all concerned, they had no cohesive force. Their weakness lay in their inability to force their agreement against offending members. They being found inadequate, gave way to another form of organization.

In 1862 we have the organization of the Standard Oil Trust. In this form of organization the holders of the stock of the various companies surrender their shares to the trustees of the trust and receive in return trust certificates upon which profits are declared. The "Sugar Trust", "Whiskey Trust", and scores of other trusts were soon organized. From the very outset public opinion was against them. Many states enacted legislation hostile to them, and their path gave promise of being an unpleasant one when this form of organization was virtually put an end to by the decision of the New York Court of Appeals in the case of the Sugar trust (Referee of the State of N. Y. vs. North River Refining Co., 121 N. Y. 582); whose action in surrendering its stock and its powers of independent control into the hands of the trust, the court declared to be illegal as being ultra vires. It is a fact worth noticing that throughout the history of the attempts of independent companies to form some kind of a union when the law of the land intervenes they do not return to their original status; but something different follows. In the case of the Sugar Trust it became an individual corporation; and thus we have the form of combination assumed by the so called trusts of today.

Since 1890 this form of combination has been going on with great rapidity. However their growth in number has not been a continuous one. For the next few years following 1890 up to 1892 there was a tremendous increase in number of the corporations formed. This number diminished during the money scarcity following the panic of 1893. The year of 1897-8 marked a reaction in the formation of corporations. During this period many of the

corporations most familiar to the American public were formed. Toward the close of the year of 1895 the sharp falling off in the sales of the securities of such corporations, together with the stringency in the money market caused another cessation in this work. The period following this reaction was marked by the formation of the most colossal of all organizations, the United States Steel Corporation. Such, in brief, is the history of the organization movement of industrial corporations up to the present time. During this period fully one seventh the capital invested in manufacturing interests has been combined.

Concerning the growth of combinations in the field of transportation we have already spoken of the Chicago-Onaha Pool of 1870. Following this pool came the Southwestern Association, organized in 1870, dealing with the traffic centering in St. Louis; The Southern Ry. and Steamship Association, which eventually came to include nearly all of the railways of the South; and in the East the pools of the roads connecting Chicago and the Sea-board, as well as the Anthracite Coal combinations. The means employed to secure the successful working of these pools were various, sometimes a division of profit, sometimes a division of earnings, or perhaps a division of territory. With the passage of the Interstate Commerce act of 1886 the railroads were forced to cease open pooling arrangements; and there grew up more strongly than before the system of absorption of the smaller lines by the larger ones until at present the greater part of the transportation business of the United States is carried on by less than a score of companies.

The function
of the
promoter.

By this time, no doubt, the question has been asked in the minds of many what has all the foregoing to do with the promoter either directly or indirectly? It is in a brief way a statement of the history of the conditions that made it possible for the promoter to do his work; as well as a statement of the immense size of his field of activity which makes his operations of such vital importance to our economic welfare. Before we can reach a conclusion as to the benefit, or the evils, arising from his work to the public, to the investor, and to the industries concerned we must go with some minuteness of detail, into the operations as carried out by this individual.

By a detailed study of his methods, as well as the conditions which prevailed in the industry which made them possible, we are in a position to judge with more accuracy of his position in the industrial world. Whether he is really a legitimate fac-

Purpose of the
investigation.

tor, a man for whom there is a legitimate need, and one for whom there is an economic need must be decided by the reader in a large measure according to his convictions concerning the desirability or non-desirability of combinations. That is not the aim of this work. It is rather an investigation of the conditions which rendered his work possible; his motives in doing it; whether he is likely to find a permanent place in our economic system; whether his work is likely to endure; is he favored too much by our state laws; his profits and his honesty to the public. These are some of the things for which a solution is sought in this investigation.

Possibly as the term promoter is rather an indefinite one in the minds of many, it might be well to state with some degree of accuracy the meaning intended to be conveyed by that word. "If" according to Professor Jenks" several different firms, or corporations are to be combined into one, or if a large corporation is to be formed, it is ordinarily true that some individual must undertake the task of carrying on the negotiations among the different establishments, or individuals concerned, of providing a plan of organization, and of persuading the different individual owners that it is to their advantage to enter into the combinations on the terms suggested. This persuasive optimist who can succeed in convincing each that it is for his interest to join the organization is the promoter"

With the larger industrial corporations came the promoter. It can readily be seen that under the conditions preceeding their advent he was not known. A pool was an agreement reached only among the owners, or the managers directly interested, yet we have a notable instance where these parties put the task of adjusting the working of the pool into outside hands; as in the case where the East and West Frunk lines called in the service of Albert Fink to help them reach a pooling basis equitable as between themselves. The work of Mr. Fink was in no sense the work of a promoter. The promoter is a manufacturer first of all, a manufacturer of securities. On the one hand he gathers together the various properties which he is to knit together into a whole; on the other hand he presents the securities Methods of which are supposed to represent the value of these promotion. properties to the investing public. The diversity of conditions

under which the labors may cause to a certain extent some variation in the method of operation. In the Moore method he buys the property outright, going to each mill owner and getting a cash option on his property. After making arrangements for the acquisition of the various properties he proceeds to form his company. In so doing he works with the end in view that ultimately the conveyors of the properties will prefer stock in the new company to cash. Therefore he capitalizes the new company sufficiently large, so that after paying all the vendors and the expense of organization, there remains a large block of stock to go to the promoter for his work. The capital stock is usually divided into two classes, common and preferred. The former usually representing the actual cash value of the property and the latter the goodwill, the franchises, trade marks, patents, etc. It is out of the last class of stock the promoter usually gets his pay.

Moore Method. Report of Industrial Commission. 1 Vol. 760.

Another method of promotion is when the parties desiring to consolidate get together and do the work of promotion of their own free volition without the aid of outside assistance. This latter method is not very common because of the great difficulty that the various owners of the plants have in coming to an agreement on the prices of their property; each one thinking his property much more valuable than that of his neighbors.

A third method is that of a body of men forming a syndicate and, going together into the open market, buying a sufficient amount of securities of the various interest which they wish to control, to give them a dominant power in the affairs of their organizations; and then proceeding to consolidate these

properties in such manner as they think best serves their purpose. This last method is used mostly in the case of railway properties.

Such is a synopsis of some of the methods used by the promoter; but to see how he does it, the amount of money required to do it, from whence this money comes, the inducements made to the owners to sell to him their plants, as well as those held out to the public to get them to buy securities, and the manner in which he disposes of his securities it is necessary to make a detailed study of some of the more representative cases.

CHAPTER 2.

American Tin Plate Company.

Judge Moore of Chicago is the most widely known of all promoters. To his credit is placed the promotion of the Diamond Watch Co., National Biscuit Co., American Tin Plate Co., Federal Steel Co., National Steel Co., American Steel Hoop Co., and later on, the reorganization of the Rock Island Railway system. It was after him that the Moore method, previously referred to, took its name; because first so extensively used by him. Of all these companies the promotion of the American Tin Plate Co. is perhaps the most typical.

The American Tin Plate Co. was incorporated under the state laws of New Jersey, January 6th, 1899. Its authorized capital stock being \$50,000,000; \$20,000,000, 7% cumulative preferred, and \$30,000,000 common. Of this sum \$18,000,000 preferred and \$22,000,000 common has been issued. Not only the causes but also the methods of its organization has been given very fully in the report of the Industrial Commission for 1900. From this report the causes leading up to its organization are given as excessive competition. The price of tin plate had fallen from \$5.20 per box in 1892, after the passage of the McKinley bill, to \$2.00 in 1899. The tariff at this time was \$1.50 per hundred. Griffiths (an independent manufacturer) states that although the profits had fallen from 100% to 20% well managed companies were making good profits. Mr. Reid, the president of the Tin Plate Co., in his testimony states that most companies were not making any profits.

*Report of Industrial Commission 1900, 1 Vol. 896-912.

In view of this state of affairs the owners of tin plate mills decided that some form of organization was necessary to enable them to keep up profits. After failing in the attempt to reach some form of an agreement among themselves they decided to call in the services of Judge Moore. With that end in view a committee of tin plate manufacturers waited on him in 1897. He was at that time engaged in organizing the National Biscuit Co. About a year after the first overtures were made to him he decided to undertake the task.

In the place of acting as an intermediary he proceeded to get cash options on the various plants. In other words he proceeded to get possession of them himself. To do this required large sums of money, which he collected from various sources. He borrowed large amounts personally, and also raised large amounts by advance subscriptions from outside capitalists. Each mill owner was approached separately, and the amount agreed upon as the purchase price was kept a secret. As he, himself, said this was necessary, since every mill owner thought his plant better than his neighbors, in a better location, and in every way more valuable. Although a cash option, the owner was given the privilege of taking his pay in the securities of the new company if he so preferred. As most of them desired to remain in the business when they saw that the promotion was going to be a success it required but little capital in order to complete the deal. The inducement offered to mill owners to sell was largely that of the hope of higher prices for tin plate in case of a combination; although the argument of economies in operation on a large scale was pressed somewhat. That the former was

the chief inducement however is shown, not only by the attempt to secure as nearly all the mills as possible in order to have a monopoly in the tin plate business; but also in subsidizing, for a term of five years, all the manufacturers of tin plate machinery in order to retain this monopoly.

The exact selling price of these plants is not known; but the general prices paid were higher than they would have been at a private sale. Mr. Reid testified that at the prices of materials prevailing at that time, a ten mill plant would cost about \$400,000. A twenty mill plant would cost more than twice as much; while it would be necessary to furnish about \$25,000 working capital for each mill.

Mr. Griffith, who sold out to the combination and has since been running an independent plant, stated that he received 25 to 30% more than the original cost of his plant. He also stated that the impression was a very general one that the standard price paid was \$40,000 a mill for each plant. This sum included good will and everything. He estimated that \$12,000,000 was ample to allow for the cost of reproduction of the plants, good will and everything at the time they were purchased.

Mr. Moore declined to affirm the cost price. Two or three witnesses made the statement that the actual cash value was fully represented by the preferred stock, or \$18,000,000. All things considered \$18,000,000 would seem a conservative estimate to put on the value of the property received.

In lieu of each \$100 in cash the mill owners had the option of receiving \$100 preferred stock, par value, and \$150 common stock,

er value. In case they exercised this option, which they uniformly did \$10,000,000 of common stock was left in Judge Moore's hands. In the course of the promotion he had issued whatever stock he deemed desirable and necessary in order to secure the various plants, and furnish the amount of working capital required. By fixing the capitalization of the new company at his own discretion he virtually fixed his margin of profits. He explained the large amount of stock retained by stating: "The organization of the Company involved very great risk: capital from the outside was hard to secure, and the manufacturers hard to bring together; a strong and effective combination must be assured in order to sell the stock; Therefore the necessity of reserves. Just what he received for his common stock is not known. At one time its market price was \$44.00. By disposing of this common stock retained by him at that time his profits would have been about \$4,400,000 for promoting the Company.

#As soon as Judge Moore had obtained possession of the various plants he proceeded to plan the form of organization and also to choose the officials. This he did with a great deal of care for not only was the form of organization important, the success of the sale of its stock depended quite largely upon the class of men at its head. To further the sale of the securities to the public he presented in the prospectus what was said to be a carefully prepared estimate of sales, earnings and profits for 1898.

These estimates were as follows: The gross output of the mills was stated to be 7,634,000 boxes of tin plate. On the basis of the then operating expenses a profit of 35 cents, or \$2,671,754 was made by

#Report of Industrial Com. 1 Vol. 755-63.

the mills when the price was lowest. Under the new arrangements the operating expenses were to be reduced by \$1,000,000. After deducting \$1,260,000 for the preferred stock, \$2,441,000 would be left as dividends for the common stock. In order that the share holders might receive the benefit of the earnings of the company, a provision was made in the Charter forbidding the directors to reserve a surplus fund not chargeable with the payment of dividends; so if any dividends were earned they would be divided. Unfortunately for the common stock holders no dividends as yet, have ever been earned. It was also provided that no mortgage should be made except with the consent of two thirds of the shareholders in writing. Both directors and executive committee were to be elected directly by the people: Such were the provisions made to safe guard the interest of the man who should seek the Tin Plate Company as a field for investment.

United States Ship Building Company.

From work of promotion successful in every sense of the word from the promoters point of view we turn to one whose ignominious failure, and whose financial loss to the promoters, most stand as a warning against the too reckless flotations of industrial enterprises, the "United States Ship Building Company".

From the very fact of its instability, its quick relapse into the receiver's hands, more light has been thrown on the inside facts concerning its formation and financiering than any of the larger corporations. But few reflect less credit on the promoters. Within nine months after its organization proceedings were instituted for a receiver.

From the facts as gleaned from the report of the Receiver, from the matters brought to light in the case of Roland H. Conklin, and other holders of the first mortgage bonds against the United States Ship Building Co., and Mr. Schwab; as well as from the "Photograph of the Organization of the Company". By Mr. L. W. Sammis the following information is presented.

The Company was incorporated under the laws of New Jersey, June 17, 1902; the incorporators being H. K. Wood, H. S. Gould, and Kenneth McLoren and the capital stock \$3,000. This Company under date of June 24, 1902 issued a prospectus with the view of inducing the public to subscribe for \$9,000,000 of its first mortgage bonds. This prospectus not only stated that the Company was incorporated under the state laws of New Jersey; it set out a list of ten directors, it stated that the subsidiary plants of the

#Report of the Receiver.

Company, exclusive of the Bethlehem Steel Co. were joint concerns that had been appraised at \$20,000,000; their working capital was over \$5,000,000; the contracts in hand for work amounted to over \$36,000,000 on which the estimated profits amounted to over \$5,000,000. It implied that the Capital Stock was \$20,000,000.

#On June 24th F. W. Seward, Raymond Newman and Louis P. Dailey, having been transferred each a share of the common stock, were elected directors. This was the directorate which purchased the subsidiary plants; raised the capital stock (with the consent of the stock holders) from \$3,000 to \$45,000,000 and issued securities to the value of \$70,000,000. When a permanent organization was effected they all resigned. Seward was asked by Alexander and Green to act as a director, and received \$20 for his services in that capacity.

On the same date, June 24th, on which the board of directors organized and increased the capital stock they received and accepted an offer from one, John W. Young, to sell them the following properties, whose total values have since been appraised at \$12,441,516.26; -Union Iron Works, San Francisco, California; Harlan and Hollingsworth Co., Wilmington, Delaware; Eastern Ship Building Co., Carteret, New Jersey; Crescent Shipyard Co., New Jersey; Samuel L. Moore and Sons Co., New Jersey; Bath Iron Works, Bath, Maine; Bethlehem Steel Co., Bethlehem, Pennsylvania.

In consideration for this property Young was to receive \$19,998,500 in par value of preferred stocks; \$24,998,500 in par value of common stocks \$15,000,000 par value of the first mortgage 5% sinking fund, 30 yr. gold bonds (these bonds were to be secured
#Receiver's Report.

by a mortgage on all the property except the Bethlehem Co.); and \$10,000,000 20 yrs. gold bonds secured by a mortgage upon the shares of the Bethlehem Co. were to be deposited with the New York Security and Trust Co., under a mortgage or a deed of trust. This mortgage was also to be a lien, subject to the priority of the \$11,000,000 bonds, upon the rest of the property of the Shipbuilding Company. The bonds thus issued on this mortgage were to have equal voting powers with the stocks; one thousand dollars par value of the bonds having the same voting power as one thousand dollars par value of the stock. The remaining provisions were that the Bethlehem Steel Company, as long as the bonds were outstanding, was to remain a distinct and separate corporation; it was to pay dividends upon its capital stock of not less than \$900,000 annually, and it was to be protected in keeping on hand annually cash assets of not less than \$4,000,000 as its working capital. Immediately upon the acceptance of this offer the stock holders ratified it and took steps to provide for the bond issue.

Between the fifth and twelfth of August the subsidiary companies turned over their properties to the present company by means of deeds and bills of sale. With the acceptance of the Bethlehem Steel Company the various vendors received \$6,000,000 cash, \$4,000,000 bonds and \$11,150,000 in each kind of stock. The Bethlehem Steel Co. cost the Ship Building people \$10,000,000 collateral mortgage bonds, \$10,000,000 each of common and preferred stocks.

#Relation of the Financial Trust Co. to the Industrial Trust. 1.30

The above facts represents what may be called the current history of the company in relation to the public which was asked to buy its stocks and bonds. Being in possession of these facts the inside manipulations of the promoting and underwriting becomes of interest. #The promoter of this company was J. W. Young. Mr. Young had been talking this matter up some months previous to his meeting with Mr. Nixon in the fall of 1900, yet he had made no substantial headway. #Mr. Nixon had recently purchased the Crescent Ship Yards at Elizabethport, N. J. for about \$7,000 and organized a company capitalized for \$1,120,000 retaining in his name all the stock except enough to qualify the directors. Young interested Nixon by allowing him an option which he had on the Newport News Ship Building and Dry Dock Co. Mr. Nixon gave him an option on his own plant and agreed to assist him. ##Col. John J. McCook, a director in the Mercantile Trust Company and a partner in the law firm of Alexander and Green agreed to assist him. He became counsel for J. W. Young, the United States Ship Building Co., and Nixon and Dresser in their joint capacity as the Ship Building Syndicate. They secured options on other companies and prepared a prospectus for issue May 7, 1901 but owing to the Northern Pacific panic the project fell through with. ###Mr. Daniel Le Roy Dresser was president of the Trust Co. of the Republic, the capitalization of which was \$1,000,000. It began business March 31st, 1902; and its main purpose was the lending of money to Southern cotton growers. When he first met Mr. Young,

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| #The Relation of the Financial Trust Co. to the Indust. Trust | P. 7 |
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which meeting was brought about through the agency of Col. J. J. McCook, Mr. Young spoke to him in regard to trading in American industrial securities on behalf of a French Syndicate. In a few weeks this project was dropped and the promotion of the Ship Building Co. was substituted. A preliminary prospectus was issued without the name of a banker; but with the Mercantile Trust Co. as trustee of the mortgage and transfer agents of the stocks. The Trust Co. of the Republic became the banker. #According to the digest of a memorandum given by Mr. Sammis at this time it was proposed to dispose of \$9,000,000 bonds and \$2,500,000 stocks of each kind in order to realize \$8,100,000 cash. Of the cash and securities then remaining in hand \$6,400,000 cash, \$4,050,000 bonds, \$4,000,000 preferred and \$4,050,000 common stock were to be paid to the owners of the properties to be acquired, leaving \$1,700,000 cash, \$2,950,000 bonds, \$3,750,000 of preferred stock and \$2,750,000 common stock. Of this \$1,500,000 in cash and \$1,500,000 bonds were to be retained in the treasury of the proposed combinations for working capital. This left \$200,000 cash, \$500,000 bonds \$3,750,000 each of preferred and common stock,- a grand total of \$9,150,000, figuring the securities at par, to go to the promoters. From it they were to pay the expenses of promotion. This division of the capital was made on the basis of a stock issue of \$20,000,000.

#The \$9,000,000 of bonds to be offered to the public was under-written under agreement between the Mercantile Trust Co. of New Jersey, and various under-writers of America and France. The agreement provided that the bonds should be offered to the public #The relation of the Financial Trust Co. to the Industrial Trust.

through such persons as might be designated by the Mercantile Trust Co. Accordingly in May 1902, J. J. McCook called on the Trust Co. of the Republic and asked them to act as bankers in the operation of placing \$3,000,000 of the bonds on the market in America, their contract being simply to procure underwriters to the underwriting contracts. Young appeared with him the next time and they asked the Trust Co. to agree to underwrite about \$2,000,000 more as England had declined to take her share; so it had become necessary to ask the French and American underwriters to increase their amounts. By the terms of the underwriting agreement the \$9,000,000 bonds were to be underwritten at 90, and each underwriter to receive a bonus of 25% of his underwriting in both kinds of stocks. They were to be offered to the public at 97 1-2. On June 14th, the date of the appearance of the public prospectus, they were offered for sale, the American public taking only \$490,000 of them. They were, however, sold in November to a syndicate of New York Bankers, which syndicate also holds most of the common and preferred stocks. The bonds were taken over by the syndicate on condition that they pay the Trust Co. one half the amount which realized on their sale.

##In France, after Young had assured the underwriters that the enterprise was a success, and they began to think that all was over but drawing their share of the profits, it was found necessary to make a call for the first payments from them. Mr. Alexander of the firm of Alexander and Green took the matter in charge, and in order to bolster up French confidence in the enterprise made many misleading statements to the French capitalists. They refused to

"Report of the Receiver.

##Relation of the Financial Trust Co. to the Indust. Trust. P. 21

advance the cash, and this in spite of the fact, that the date set for the delivery of the properties was fast approaching, when it would be necessary for the promoters to have the money.

To better show the crisis which was facing the promoters at this time, it is necessary to go back a little. As originally contemplated, the United States Shipbuilding Co. did not include the Bethlehem Steel Co. About the 12th. of June, however, Schwab made overtures to the promoters to sell them the Bethlehem Steel Co. this company was earning at the rate of about \$1,500,000 a year, also it would enable the Shipbuilding people to build armored vessels for the government, hence its desirability. But in the terms by which it was to be acquired all of the titles to the other subsidiary companies were to be vested in the Shipbuilding Co., it having paid for them, before taking over the Bethlehem Steel Co. The Bethlehem people refused an extension of time. Therefore to secure the money needed, although the Shipbuilding Co. had no right whatever to issue any bonds prior to August the 11th., the date it was to take over the properties, Nixon and Dresser took these bonds and the other funds of the Trust Co. of the Republic to other institutions where they deposited them; also giving them their joint note, and the guarantee of the Trust Co. of the Republic. The money advanced to them was made payable to them personally. These sums were deposited with the Trust Co. of the Republic. In this way, through the funds of the Trust Co. of the Republic, Nixon and Dresser secured \$3,672,187.50 in cash,

#and

##Relation of the Financial Trust Co. to the Indust. Trust pp 17-18
 # " " " " " " " " " " " " p. 20.

which supplemented by the \$2,327,812.50 receive from the underwriters enabled them to take over the properties. Since the sum of \$3,000,000 was deposited with the Trust Co. of the Republic it could not loan it to its president; therefore this sum was loaned to Lewis Nixon in return for his personal note secured by the stocks and bonds of the Shipbuilding Co.

The sum of \$3,672,187.50 loaned by the Trust Co. of the Republic to Nixon and Dresser on the strength of the subscriptions of the French underwriters was afterwards reduced to \$982,354.10[#] which sum that Company lost in the venture.

On the 12th of August the Bethlehem Co. was taken over. As previously stated this property was purchased of Mr. Schwab for \$10,000,000 in bonds, he alleging that it had cost him \$7,000,000 or \$24.00 a share the previous November. When the contract came to be drawn up it provided that J. P. Morgan and Co. were to be the vendors, and they were to receive \$7,243,871.48 in cash for the property as well as \$2,500,000 in each kinds of Stocks. Schwab furnished the cash. In return for that he received \$10,000,000 in bonds and \$7,500,000 in each kinds of stocks. This \$10,000,000 in bonds as previously stated was to have the same voting power as the stocks, thus making Schwab virtually master of the new company.

##Furthermore by an agreement made between Dresser and Nixon of the first part and Schwab and Morgan of the second part and Harris and Gates of the third part on the 11th of August 1902, the stock was to be distributed as follows: \$10,000,000 of each kind went to Morgan and Schwab in part payment for the Bethlehem plant,

#Relation of the Financial Trust Co. to the Indust. Trust. p. 33.

##New York Journal of Commerce and Commercial Bulletin Oct. 12, 1902

\$1,500,000 of each kind to be distributed among the various vendors of the properties to the Shipbuilding Company of which Nixon was one, and the remainder of the stocks to be deposited with the Trust Co. not to be transferred or disposed of until the other stocks were sold.

This in brief is the history of the promotion of an organization where a total disregard for conservatism and even ordinary business discretion paved for it a speedy path to ruin.

International Mercantile Marine Company.

Turning from the attempt made by Mr. Nixon to promote the United States Shipbuilding Co. to that of Wall Street's most successful financier in promoting the International Mercantile Marine we see at once the superior powers of organization possessed by Mr. Morgan.

When J. P. Morgan and Co. purchased the Leyland transportation line, in May, 1901, it was currently stated that the intention was to secure an independent line for the transportation of the Steel Trust products, as well as to expedite the Ship Subsidy Bill then pending. Further developments of facts, however, disclosed another purpose in view. This purchase marked the beginning of the organization of the International Mercantile Marine Co. This Company included the following lines:

| | No. of vessels. | Ton- nage | Capt. Stock. | Dividends in 1902. | Bonds.. |
|------------------------|--------------------|--------------|-----------------|-----------------------|--------------|
| #1. White Star Line | 29 | 206,000 | \$3,750,000 | 10% | |
| 2. Internat. Nav. Co. | 24 | 179,000 | 14,200,000 | 4% | \$13,686,000 |
| (a) Red Star Line. | | | | | |
| (b) American Line. | | | | | |
| 3. Leyland | 46 | 293,000 | 2,615,000 | 6% | |
| 4. Atlantic Transport. | 20 | 195,000 | 5,000,000 | 1-2% | |
| 5. Dominion. | 8 | 74,000 | 3,000,000 | | |
| Totals | 127 | 907,000 | 40,658,900 | | \$13,686,000 |

The total capitalized value of the properties taken over including their bonds, approximating the value of the Dominion line,
The Economist. 645 vol. 60.

Journal of Commerce and Commercial Bulletin. May 19. 1902.

at \$3,000,000, was about \$54,000,000.

The principal lines not included were:

| | No. of vessels | Tonnage | Capit. stock. | Dividends in 1902. |
|--|-------------------|-----------|------------------|-----------------------|
| 1. Hamburg-American. | 279 | 661.335 | \$25,000,000 | 6% |
| 2. North German Lloyd. | 315 | 587.000 | 25,000,000 | 6% |
| 3. American S. S. Co. (including vessels in the oriental trade.) | 24 | 14.410 | 10,000,000 | |
| Holland American. | 10 | 79.000 | 8,000,000 | |
| <hr/> | | | | |
| Total | 628 | 1,341,745 | 68,000,000 | |

#The following is a brief history of the various subsidiary Cos:

Leyland Line; Incorporated 1901; including Frederick Leyland and Co., Limited; Wilson and Furniss Leyland Line, Limited. West India and Pacific Steamship Co., Limited. Its total capital stock was £ 2,800,000 issued in 150,000 5% preference shares and 130,000 common.

White Star Line: The fleet of steamers which sailed under the flag of the White Star, belonged to the Oceanic Steam Navigation Co., Ismay, Imire and Co. This was a private concern, originally chartered in 1869 and £ 400,000 capital in £ 1,000 shares. In 1872 this was increased to £ 500,000 and a little later to £ 750,000. It has no directors.

###International Navigation Company: This company was incorporated in New Jersey, June 6th, 1893. It owned the Red Star and American Lines. In addition to its capital stock of \$14,200,000 it had \$13,500,000.

#Com. and In. Chronicle 74 vol. 888

##Journal of Commerce and Commercial Bulletin, May 21st 1902.

###Investors Supplement 1900, page 164.

underlying bonds.

The Atlantic Transport Co., Limited. Registered in 1889 with a capital stock of \$100,000 in 20 shares. By 1889 it had increased its capital stock to \$900,000. In that year it took over the Atlantic Transport Co. of West Virginia. In 1900 \$1,000,000 was added to the Company in the form of preferred stocks none of which however, has been issued.

Having this knowledge of the constituent companies, their properties, the amount of their capitalizations and their ownership we are ready for an inquiry as to how they were combined together to form what is popularly known as the "Steamship Combine".

This work was mainly accomplished in the latter half of 1902 when the Republic was already over satiated with securities, in the face of the distrust of the British ship owners, a hostile English press and a stringent money market. It had however two redeeming features, it was backed by J. P. Morgan and Co., and it was undertaken at a time when the profits of the shipping industry had been abnormal. Yet the fact that Mr. Morgan was able to take these properties, whose total value did not exceed \$54,000,000. place them on the market with a total capital of \$170,000,000 speaks well for his ability as a financier.

As has been previously stated the Leyland Line was the first line secured by Mr. Morgan. He secured control of this line in May 1901 by purchasing its common stock, paying £14. 10s for each £14 shares. Their market value at that time was £14. The company retained its preferred stock. Mr. Morgan's next move was to get possession of the White Star, Dominion, American and

Atlantic lines. ~~##~~ This was accomplished by a provisional agreement of Feb. 4th, 1902. This agreement was made optional on the part of Morgan and Co. until April 30th. As he closed the option, and this agreement became the one under which the subsidiary companies were secured; and as it gives the purchase price as well as the method of payment its contents became of decided importance.

~~##~~This agreement was made Feb. 4th, 1902 between Ismay, Imirie and Co. (White Star vendors), Richard Mills and Co. (Dominion vendors), Peter A. B. Widener and Clement Griscom (American vendors), Bernard H. Baker (Atlantic Transport vendor) and J. P. Morgan and Co., termed the "Bankers". The object was stated to be the acquisition of certain maritime properties and interests by a corporation to be organized under the direction of the vendors to the satisfaction of the "Bankers" for, and in consideration of the issue therefor to the "Vendors", or their representatives, the total capitalization, being \$120,000,000 in stocks, and \$50,000,000 of collateral trust debentures.

The properties to be acquired were: (a) 750 shares (total issue £750,000) of the capital stock of the White Star Line; also as far as the White Star vendors are able to dispose of it, the position of the managers of the Oceanic Steam Navigation Co. (b) The business, good will, and assets of the firm of Richard Mills and Co. in connection with the British and North American Steam Navigation Co. (Limited), and the Mississippi and

~~##~~ New York Journal of Commerce and Commercial bulletin May 16, 1902
~~##~~ N. Y. Journal of Com. and Com. Bulletin, May 19, 1902.

Dominion S. S. Co. (c) The Capital stock, property and assets of the Atlantic Transport Co. (d) The capital stock, property and assets of the International Navigation Co.

(e) 118,463 ordinary shares and 58,703 preferred shares of the capital stock of Frederick Leyland and Co., Limited.

The acquisition of the White Star and Dominion Lines was to be dated from January 1st.. 1901 and they were to receive 5% interest on the purchase price from that time.

The considerations agreed upon were: (a) For the White Star Line, ten times the net profits of the company for the year 1900. (b) For the business of Ismay, Imire and Co. including their properties good will and assets ten times their net profits for the year 1900. (This does not include their profits from the White Star Line.) Ismay, Imire and Co. agreed to stay out of business for fourteen years. They were paid as vendors of the White Star Line, 25% in cash, 25% in common stocks and 75% of preferred stocks. The valuation of the Dominion Line together with the business of Richard Mills and Co. was determined in the same manner and they were paid 25% in cash, 37% in common stock and 75% in preferred stock. The American Line (International Navigation Co.) and the Atlantic Transport Co. were paid \$18,000,000 in preferred stocks at par, \$9,000,000 in common stocks and \$16,000,000 in cash. (The cash was for new tonnage not included in the delivery of the property and also to pay the debts with interest at 6%). It was to be advanced when needed. They paid \$11,736,000 cash for the Leyland Line.

The agreement further specified that all orders for new vessels and for heavy repairing requiring to be done at a United Kingdom shipyard was to be given to Harlan, Wolff and Co., the latter agreeing to accept no orders from any other firm as long as the steel ship combine kept them busy. This agreement was probably made in order to secure a community^{of} interests with the Holland Line; as Mr. Pirie, one of the principal owners of the Harlan, Wolff Ship Building Plant was also one of the largest owners of the Holland lines. Through him a working agreement was reached with the Holland Line.

All of the remainder of the common and preferred stock was retained by the vendors, who, however, contributed to the corporation as working capital \$786,000 in preferred stocks and \$6,500,000 in common stock at par. They transferred the \$50,000,000ⁿ debentures, \$2,500,000 preferred stock and 2,500,000~~x~~ common stock of the corporation to the underwriting syndicate for \$50,000,000 in cash. Counting the bonds at par value, the preferred at \$90 and the common at \$40 this would give the syndicate a profit of \$12,500,000. Mr. J. P. Morgan was to receive for his work in organizing the steam ship Co. 5,000 shares of preferred stock and 25,000 shares of common stock. These shares were to be deducted from the amount the syndicate received. Deducting the value of the shares which at the above rates are \$1,450,000 the syndicates have a net profit of \$10,050,000.

The underwriting syndicate mentioned above was organized by J. P. Morgan and Co. The New York Journal of Commerce says it is the same one that underwrote the Steel Trust; that its existence was about to expire on the 15th. of May, and it was re-

newed for this latter work. 60% of the capital was underwritten at home and 40% abroad. The first call was made on the underwriting syndicate May 4th. 1902 for 25%. By October 1902 80% of the underwriting had been called for. The stock was subscribed and paid for by those in the corporation.

#On October 1st. 1902 these various properties were organized under the title of the "International Mercantile Marine Co." The company did not receive a new charter; but used the charter of the International Navigation Co., a New Jersey corporation, whose charter was amended and changed. The capital stock was increased from \$15,000,000 to \$120,000,000—\$60,000,000 common and \$60,000,000 preferred. (the dividends were limited to 10% as long as any of the bonds were outstanding); also \$50,000,000 collateral trust bonds bearing interest at the rate of 4 1/2% per annum, payable in 20 years, the right being reserved to redeem the same after five years at \$105. Its internal organization very closely resembles that of the organization of the Steel Trust.

As a part of the organization scheme, sometime previous to May, 1902, Mr. Morgan, on behalf of the company he was organizing, entered into an agreement with the Hamburg-American and North German Lloyd lines by which,—"##The two German Cos. agree each to pay to the corporation an annual sum equal to the dividends on \$50,000,000, or one fourth of their capital stock, this amount to be increased proportionally as their capital stock was increased. In return for which the corporation agreed to pay the two companies 6% annually on a corresponding capital"

Investor's Supplement 1900, page 158.

##N. Y. Journal of Commerce and Com. Bulletin. May 26th., 1902.

This agreement was also accompanied by a division of territory. The corporation was not to send any vessels to German ports without the consent of the German Lines; while the German Lines were to limit their traffic between England and America. A pooling agreement was also entered into with regard to the cabin and steerage passengers on the North Atlantic Lines. To adjust all matters of dispute between the two parties a board of arbitration was provided.

An agreement was also entered with the English Cos., in order to allay English hostility to the scheme, by which British vessels were to remain British in reality; to continue to fly the English flag, to be officered by English officers, and to carry English crews as far as possible.

The above is a brief historical account of the organization of the maritime enterprise, which at that time of its inception, proved such a source of alarm to the British shipping public; and which since its inception has been the source of so much loss to the American security holders.

Promotion of the United States Steel Corporation.

The causes for the organization of the United States Steel Corporation are largely to be found in the conditions existing in the iron and steel world. It is true that there were certain economies to be effected by such an organization. Economies in the utilization of ores, in transportation and manufacturing processes were all considerations of no small weight; but if there had been no other consideration the work of the promoter would have been indeed a most stupendous, if not an almost impossible one.

The latter part of 1898 and the opening months of 1899 were marked by the formation of several large iron and steel companies, including the "Federal Steel", "American Steel Hoop", and the "American Sheet Steel Co." The two preceding years had been prosperous ones in the iron and steel trade. As all of these companies were capitalized on the basis of their earning powers, their capitalization in proportion to their actual assets, as a very large one. In no case had it been the policy of the directors to accumulate a reserve fund. In every case their preferred stock was a cumulative one. From these considerations it can readily be seen that they were in no condition either to endure a period of depression or to withstand severe competition.

On the other hand there was another company which had not kept so close to the motto of large dividends at the risk of stability, The Carnegie Company. Since 1882 it had inaugurated a policy of controlling all the factors contributing to the production of iron

Trust Finance, part 197

4-11 " " " 1901

and steel. It had continued this policy until it was in possession of two thirds of the Coking Coal in the Connellsville region. It had vast ore interests in the Mesabi and Lake Superior ranges; also a fifty year contract with the Rockefeller mining and ore interests by which vast quantities of soft ore were obtained. This ore it transported, partly in its own fleet, and partly by long time contracts, at very low prices to Connecticut Ohio. From there it was transported by their own roads to the mills of Duquesne. Furthermore, the Carnegie mills were physically the best equipped in the world. They were concentrated in the center of the best steel market in the United States; while the mills of most of the other companies were widely scattered. The company had at its head the greatest steel manufacturer ever engaged in the business. By virtue of the above advantages the owner of this company was king of the steel world, hated and feared by the other manufacturers accordingly.

Until the fall of 1900 there had been little competition among these various companies. Orders had been abundant and the profits

large. The Carnegie Co., the Federal Steel Co., and the National Steel Co. were the three concerns most largely engaged in the production of steel rails, billets, slabs and bars. They had supplied these materials to the National Tube Co., The American Steel and Wire Co., the American Tin Plate Co., the American Steel Hoop Co. and the American Sheet Steel Co. These companies had manufactured the billets and bars into their final products. The Federal Steel Co. was located in the West, The Carnegie Co. in the East, while the National Steel Co., supplying most of its output

"Trust Finance, page 200.

" " " 199.

to the Steel Steel, and these companies was not a very strong competitor to either. When, in the latter part of 1900 the price of steel products began to fall, in order to meet their obligations, a policy of retrenchment became necessary on the part of all of these companies except the Carnegie Co. These companies had seen the great advantage possessed by the Carnegie Co. in its industrial independency, and they sought to secure like advantage for themselves. At once the manufacturers of finished products began to prepare to produce the iron and steel needed themselves. The Federal Steel plant and the Carnegie plant found themselves confronting the prospect of a loss of their customers. They would be compelled to seek elsewhere for a market for their products, or resort to competition with their former customers by finishing the iron and steel which they produced into its final form. They chose the latter. When the finishing companies after managing to secure the raw materials, and arranging for its transportation, began preparations for building mills to use this material; the Federal Steel and Carnegie Companies began preparation to establish plants in which they could work their billets and slabs into the finished forms. As a result of this the following situation existed: The American Steel and Wire Company, was preparing to build a large mill at Milwaukee which would make them independent of the Federal Steel Co. They had already begun the installation of a complete system of production below Pittsburg. As a counter move the Federal Steel Co. put their threats to erect their own plant into such tangible form that the former company had decided to renew its contracts a while longer.

On January 12, 1902 the Carnegie Co. announced its intention of building a large tube mill at Conneaut, Ohio. They proposed to build a sheet steel mill at Homestead, and they further more had in contemplation a railroad to the sea-coast. A war of competition seemed inevitable in which the Carnegie Co. must eventually emerge victorious. The industrial situation pointed that way. However, the holders of the large amounts of stocks in the various companies realized that such a war would mean, first a suspension of dividends, then a decline in the value of the stocks, with consequent curtailment of their financial operations at a time when they promised large profits.

In the early part of 1901 the prices of iron and steel began moving upward, the money market became easier, with a consequent increased willingness on the part of the public to buy securities of industrials. These conditions made it possible to avoid the war. They made possible the formation of the Steel Trust; even more, they made it possible for the promoters of that enterprise to secure for the stock marketed a price much above its real value.

The plan for the consolidation of the various companies was prepared by J. P. Morgan and Co. This task had first been undertaken and abandoned by Judge Moore of Chicago. By Method of the Morgan plan this new company was to be a holding company. Mr. Morgan began work in December 1900. He first secured the co-operation of the largest stock holders in the various concerns to be taken over.

#Trust Finance, page 216.

#Report of Industrial Commission.

###Com. and Fin. Chronicle 72 Vol. 441.

###Report Industrial Commission 1900, 13 Vol. 475.

He then arranged with the Carnegie Co. the terms on which its stock was to be secured. His next step was to form an underwriting syndicate representing 200,000,000. This syndicate included many prominent financiers in both Europe and America, J. P. Morgan & Co., and also many of the large stockholders in the several companies. This syndicate of which J. P. Morgan & Co. was to act as its agent made a contract with the United States Steel Corporation which provided that the Steel Co. was to issue and deliver to the syndicate its stocks and 5% gold bonds in consideration of the stocks of the subsidiary companies to be included, the bonds of the Carnegie Co. and \$25,000,000 in cash. #

On Feb. 5th. 1901, the Steel Corporation was incorporated under the state laws of New Jersey with a capital stock of 60,000. On March 2nd. its prospectus appeared. The prospectus was addressed to the holders of stocks of the Federal Steel Co., National Steel Co., American Steel and Wire Co., of New Jersey, American Tin Plate Co., American Sheet Steel Co. and the American Steel Hoop Co. These companies in connection with the Carnegie Steel Co. represented from 65% to 75% of the yearly output of iron and steel in the United States. The prospectus was signed by J. P. Morgan & Co., Syndicate Managers. It contained an account of the formation of the Syndicate and its contracts with the Steel Corporation. It stated that the Syndicate had made an arrangement with the Carnegie Co. to secure all of their stocks and bonds. The Steel Corporation itself was to issue no bonds except those required for the purpose of securing 60% of the stock of the Carnegie Co.

Prospectus issued to shareholders of Subsidiary Companies.

Then followed an offer to exchange the stock of the new company for the stock of the various companies upon the following terms: For each \$100 par value of the stocks mentioned below the amount set opposite thereto in preferred or common stock of the United States Steel Corporation at par.

| Name of Co. and Class of stock. | | Am't. of new stock to be delivered in par value. | |
|------------------------------------|-----------|---|--------|
| | | Preferred | Common |
| 1. Federal Steel Co. | Preferred | 110 | |
| | Common | 4 | 107.50 |
| 2. Am. Steel and Wire Co. | Preferred | 117.50 | |
| | Common | | 102.50 |
| 3. National Tube Co. | Preferred | 125 | |
| | Common | 8.50 | 125 |
| 4. Am. Tin Plate Co. | Preferred | 125 | |
| | Common | 20 | 125 |
| 5. National Steel Co. | Preferred | 125 | |
| | Common | | 125 |
| 6. Am. Steel Loop Co. | Preferred | 100 | |
| | Common | | 100 |
| 7. Am. Sheet Steel Co. | Preferred | 100 | |
| | Common | | 100 |

This stock was to be transferred to J. P. Morgan & Co. who were to turn it over to the Steel Corporation in consideration of the stocks of that corporation. J. P. Morgan & Co. retained the privilege of returning all stocks deposited with them if they deemed it best to abandon the enterprise. The capital stock was to be \$350,000,000 one half common and one half 7% cumulative, preferred. Bonds were not to be issued in excess of \$304,000,000. All of the stock of the Steel Corporation left in the hands of the syndicate after making the exchange were to belong to them. The forms of the new bonds, the indentures securing the same, and the entire plan of the organization and management was to be decided by J. P. Morgan & Co.

Statements were made declaring the earnings of the various companies for the last year were ample sufficient to pay a dividend on all capital stock which it was proposed to issue, besides making a provision for a sinking fund and a maintenance of the property. The belief was expressed that "By the consummation of the proposed arrangements the necessity of large deductions hitherto made on account of expenditures for improvement will be avoided, the amount of earnings applicable to dividends substantially increased and a greater stability of investment secured, without necessarily increasing the price of the manufactured products."

In the first week of March the New York Exchange admitted to quotations in the unlisted department the certificates of deposits issued by the depositaries for the stock of the seven constituent companies exclusive of the Carnegie Co. #The limit for depositing the stock with J. P. Morgan & Co. was fixed at April 1st, 1901. During the month of March arrangements were made to secure the control of the Lake Superior Consolidated Iron Mines Company and The American Bridge Co. Their combined capital stock was \$90,000,000 for which they received 720,000 shares of common stock and 740,000 preferred stock representing a total par value of \$140,000,000. The exchange was made on the basis (par value) of:

| | | U. S. - S. C. Stocks | |
|-------------------------|-----------|----------------------|------------|
| | | Common | Preferred. |
| American Bridge Co. | Common | 105 | |
| | Preferred | | 100 |
| L. Sup. Con. Iron Mines | Common | 135 | 135 |

#The amended certificate of incorporation was filed April 1.

#Fin. and Com. Chronicle.

#Articles of Incorporations and By-laws.

1901, with a paid up stock of \$1,100,000, 75% divided into equal amounts of common and 75% (cumulative preferred stock). The increase of the capital stock was due to the acquisition of the Lake Superior Consolidated Iron Mines Co. and the American Bridge Co., and in view of the Company acquiring other property.

The real value of the property taken over has been variously estimated. Ex-president Schwab testified in the suit brought to restrain the conversion of 200,000,000. of stocks into bonds that the value of the property was:

| | |
|---|-----------------|
| 1. Iron and Bessemer ore properties----- | \$100,000,000 |
| (conservative estimate) | |
| 2. Plants (including 440 producing mills machinery, tools, equipment and real estate)----- | \$50,000,000 |
| 3. Transportation properties(including 1,467 miles of Ry. and 112 ships which probably could not be duplicated) (at listed price)----- | \$20,000,000 |
| 4. Blast Furnaces ----- | \$5,000,000 |
| 5. Natural Gas Fields ----- | \$20,000,000 |
| 6. Limestone properties ----- | \$5,000,000 |
| 7. Cash and cash assets ----- | \$15,000,000 |
| Total----- | \$1,400,000,000 |

Professor Jenks estimated the value of the property to be about \$150,000,000. He places the amount of the stock of the subsidiary companies to be \$250,000,000. When recognizing the fact that most of the constituent companies had been recently consolidated and their stocks increased from 100 to 200 of their real value, we must conclude Professor Jenks's estimate the more correct. Report of Inc. Gen. 1900 1. Vol. 517-2

carried on.

The profits accruing to the syndicate and the promoters in this instance was a large one. C. P. Morgan & Co. receive as promoters pay for their work only in connection with the syndicate. The original syndicate subscribed----- 200,000,000
actually paid in ----- 12,500,000

This amount was soon repaid and it was followed by four dividend payments of \$10,000,000 each. They had left 40,000 preferred shares which, by subscribing for \$5,000,000. in the stock conversion syndicate they were enabled to unload at par value, making their operations as follows:

| | |
|--|-------------|
| Nominal Liability of the syndicate ----- | 200,000,000 |
| Actual cash paid in ----- | 12,500,000 |
| Cash dividends, \$3.25 on amt't subscribed ----- | 13,000,000 |
| Paid up subscriptions in the stock Con. syndicates ----- | 4,000,000 |
| Total Profits ----- | 50,000,000 |

THE CONSOLIDATED TOBACCO COMPANY.

As the United States Steel Corporation represents the greatest achievement from the standpoint of a promoter outside of the industry he is promoting, the formation of the Consolidated Tobacco Co. represents one of the greatest achievements in the manufacturing field by a man inside the business. The one man more responsible for the existence of the Consolidated Tobacco Co. than any other is James B. Duke. The foregoing Company was incorporated under the state laws of New Jersey June 5th. 1901. At the time of its incorporation it had a paid up cash capital of \$30,000,000 in common stock. It has never issued any preferred stock.

The condition giving rise to the formation to this company may be briefly stated thus: In 1890 the five large companies engaged in the manufacture of cigarettes in America, under the management of Mr. Duke were consolidated into the American Tobacco Company. This company had a capital stock of \$25,000,000 and controlled over 75% of the out put of cigarettes in America. Later its capital stock was increased to \$75,000,000. The Subsidiary companies manufactured also a certain amount of smoking tobacco, which brought them into competition with the other manufacturers of smoking tobacco. The American Tobacco Company in the latter half of the last decade began a campaign Earl Mayo's "Tobacco War". Frank Leslie's Magazine, March 1901. Moody's Manual. Report of Ind. Com. 1900. Tobacco War, Frank Leslie's Magazine, March 1903.

with the end in view of not only controlling the Smoking Tobacco business but also the plug tobacco business. In this latter industry Lollard and Co., and Ligget and Meyers were the two largest competitors. The firm of Ligget and Meyers were especially hostile to the "Trust." They declared their intention of never selling out to it. As the Ligget and Meyers Co. was the largest manufacturer of tobacco in the world, it was essential that the Trust secure their plant if it was to be dominant in the tobacco business.

A war of competition ensued, in this competitive war the American Tobacco Co. bought out the famous "Battle Ax" and "Honesty" brands of chewing tobacco. So fierce was the war that the "Trust" spent \$4,000,000 in advertising the "Battle Ax" brand alone. In 1898 the United Tobacco Co. was formed ostensibly for the purpose of uniting the tobacco companies fighting the "Trust". This company secured possession of the majority of the stock of the Ligget and Meyers Co., and six months after its organization the "Trust" had obtained possession of it. The tobacco trust now had the entire domestic field practically free from all competition.

In December 1898 the Continental Tobacco Co. was formed with a capital stock of \$100,000,000. \$50,000,000 each preferred and common stock. # The American Tobacco Co. being a manufacturer of cigarettes and smoking tobacco, and the new company manufacturers of plug tobacco, sold its plug interest to the new company. Through this sale it became possessor of the majority of the stock of the new company, and James B. Duke was

Report of Industrial Com., 1900. 13 Vol. 317-32

soon president of both companies.

Exclusive of the snuff trade these two companies controlled the tobacco situation. #In order to control that important industry the American Snuff Co. was incorporated, the securities of which were held jointly by the two companies.

As these three companies were practically controlled by the same interests a more perfect unity of management was sought. This was obtained through the organization of the "Consolidated Tobacco Co." ##This company was capitalized at \$1800. Shortly after its incorporation the president, Mr. Duke, issued a prospectus calling the attention of the share holders of the two companies to the fact that the company had been organized as a holding company; and offering to exchange its bonds for the common stocks of the two companies upon the basis of \$100 in bonds, par value, for \$50 common stock, par value of the American Tobacco Co.; and \$100 in bonds par value, for \$100 in stock par value of the Continental Tobacco Co. The capital stock was to be increased to \$30,000,000 common stock and the bond issue was not to exceed the amount necessary to make the exchange for the stocks of the two companies upon the above basis. ### These stocks to be exchanged were to be deposited with the Norton Trust Co. of New York which was to issue 50 years, 4%, gold bonds for them.

Just what profit, if any, Mr. Duke received for his work as promoter does not appear. He was primarily a manufacturer of tobacco and not of market securities. Doubtlessly the organization of the holding company was attended with some profit; that

#Frank Leslie, March 1903, Tobacco Trust.

##Articles of Incorporation and By-Law, of Consolidated Tobacco Co.

###Prospectus issued by company.

however was only of secondary importance to him.

The wisdom of the unity of the two companies was shown by the tobacco war which followed with the English Companies. The result of this war was that the Consolidated Company was left supreme in the United States, Cuba and the Phillipines; to their opponents was left Ireland and England; while the entire tobacco trade in other countries where tobacco is not a government monopoly, virtually fell into the hands of the American Co. which controls the company organized for the purpose of carrying on the foreign tobacco trade. With the exception of the cigar business, a business into which it has recently gone into quite extensively through the organization of the American Cigar Co., the Consolidated Tobacco Company is virtually master of the tobacco trade. It has been the means of lessening the great waste through competition in the industry, the end which Mr. Duke declares he had ultimately in view when he undertook the work of organization. Furthermore it has concentrated to a great extent the control of the business. Previous to the organization of the new company \$38,000,000 in stocks was required to direct and control the policy of the two companies; since then, as the organization of the company provided for a capital stock of \$30,000,000 any sum in excess of one half that amount is sufficient to wield control of a property whose value is upwards of \$175,000,000.

Frank Leslie's Magazine, Mar. 1903. "Tobacco Trust" Earl Mayo.

The Northern Securities Company.

After a brief review of the promotions of the larger industrial interests we turn now to a study of the methods of promotion in the field of transportation.

The stirring events leading up to the organization of the Northern Securities Company, involving as they do, a clashing of interests in some of the greatest railway properties of the West; the mad struggle for the control of a certain railway stocks that all but precipitated a panic national in its scope; the magnitude of the interests involved; the peculiar form of organization adopted and the recent interference on the part of the United States government, with that peculiar form of organization all combine to make a most interesting study. All of the facts connected with this organization are matters of history. As an illustration of the economic situation out of which emerge so called combinations and monopolies; as an example of the means used to consolidate various interests, and place in the power of a few capitalists the prosperity and growth of a vast and fertile section of a country with a population extending into the millions; and as an outgrowth of a peculiar principle of consolidation the Northern Securities Co. is well worthy of careful investigation. The basis of combination was the "community of interests" and the form of the organization one best suited to secure that end.

In the Northwest, there had in the last half century grown up two great railway lines extending from the Mississippi valley

*Prof. Wilgus, Michigan Law Review, Vol. 251

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to the Pacific Coast, -the Northern Pacific and the Great Northern. The former was chartered in 1884. It extended from Duluth to Tacoma. In 1893 it had gone into the hands of a receiver, its bankrupt state being brought about through competition with the Great Northern. By 1895 J. P. Morgan and Co. had completed the plan of its re-organization. Through this plan of re-organization 4,706 miles of railroad were welded together, and \$147,000,000 old securities taken up with \$22,700,000 new ones. In this process, \$46,550,000 common stock and \$10,800,000 cash and \$17,500,000 preferred stock were exchanged for \$84,000,000 of the old stock, leaving \$72,000,000 of new stock (the total issue being \$155,000,000) to be divided among the re-organization syndicate. Jas. J. Hill and his friends acquired a total amount of \$26,000,000 of the new stock. Thus it can be seen that while J. J. Hill was the predominating factor in the Northern Pacific that J. P. Morgan & Co. by reason of their work of re-organization were interested in it to a certain extent.

The Great Northern Railway System was started in 1857. In 1889, under the influence of J. J. Hill this line was re-organized under the present name. Its capital stock was fixed at \$20,000,000 and its bond issue at \$80,000,000. It has since been purchased by the Great Northern Co. This Co. acquired possession of it by giving in exchange \$25,000,000 of its own stock for its \$20,000,000 capital stock. This road extended about 100 miles north of the Northern Pacific from Duluth to Everett on Puget Sound. It also has a steamship line from Duluth to Buffalo.

There was yet a third company whose lines and ramifications connected the larger cities of the middle west, -The Chicago Burlington and Quincy. Originally chartered in 1851, it had grown to a system embracing 2,151 miles with lines connecting Chicago and St. Paul; Chicago, Lincoln and Omaha; and even extending as far west as Billings Montana, on the Northern Pacific; Chicago, St. Joseph and Denver; as well as lines connecting St. Louis and Kansas City with the above cities.

There were many reasons why this road would be a valuable possession to the two Northern roads. There were reasons also why it would be a valuable acquisition to the Union Pacific, a road controlled by the Harriman interests and lying south of the Burlington. In the first place the two roads entering Duluth needed a Chicago connection, -the Burlington furnished it. The further advantages of the control of the Burlington as pointed out by President Hill were "The Burlington is favorably located, with ample terminal facilities in the great traffic centers of the middle west. In the south it connects with the chief cotton carrying lines; it serves a country furnishing most all of its own products except timber; a country furnishing the chief products exported to Asia. These products the Burlington line would furnish to the Northern lines, while in return it would receive from them the timber of Washington and the live stock of the northwest grazing country".

On the other hand the Burlington was talking of building through to the coast. In this case its competition would be ruinous to the Northern Pacific. Should the Union Pacific let it fall into the hands of the Northern Pacific, from Billings eastward

it would be an unpleasant competitor. Therefore, when in April, 1901, it became known that the Great Northern Co. and the Northern Pacific had jointly purchased the Burlington it immediately demanded a share in the purchase as well as a favorable trackage rights over the lines of the Burlington as the purchasing companies. #The two Northern roads had paid the Burlington \$200 a share while its value was \$100 and the market value \$130, issuing therefore their joint bonds. Deeming themselves secure in its possession they refused the Union Pacific's request. Immediately that road set its agents at work in Europe to buy up Northern Pacific stock. By the first week in May they were the owners of over \$60,000,000 of the stock. The situation was alarming to the Hill-Morgan crowd. If the Union Pacific should control the Northern Pacific that meant on their part a control of a half interest in the Burlington. As Mr. Hill told his friends "Everything in the west was theirs from Canada to Mexico except the Great Northern."

#Mr. Morgan, as he said, seeing that the desire of the Union Pacific to secure the control of the Northern Pacific was not to manage it with its best interests in view but for an ulterior object, began, without the advice or acting on behalf of any one else, and actuated only by motives of serving the interests of a road which he had helped to re-organize began buying Northern Pacific stock. Stock that had only nine months before sold at \$45.75 was soon selling at \$1000 a share. As a result of this effort to secure control of the contested line the country was all but precipitated in a panic.

#Legal News, March 23rd, 1904.

##Legal News, March 23th, 1904.

Mr. Morgan arranged a meeting of the contestants and it was discovered that the Morgan-Hill interests controlled \$42,000,000 common stock and the Harriman interests \$41,000,000 preferred and \$37,000,000 common stock. A truce was entered into whereby Mr. Morgan was left to name the Northern Pacific board of directors. This seeming surrender on the part of the Union Pacific interests to their opponents was due to the fact that by a provision in the Northern Pacific charter the common stock could pay off and retire the preferred stock on the first of January of any year that they chose to do so. Mr. Morgan named the following directors; J. J. Hill, of the Great Northern Co., E. J. Harriman of the Union Pacific, Wm. Rockefeller of the Chicago, Milwaukee and St. Paul; H. Mc. Twombly of the Chicago and Northwestern and Samuel Rea of the Pennsylvania Ry. Co. On the first of October the above mentioned were elected directors. It then became evident that the preferred stock would be retired, although strongly opposed by the Harriman interests. Since, however, they could'nt help themselves they proposed selling out the Union Pacific holdings of Northern Pacific stock to J. P. Morgan & Co.

To provide the capital for his purchase was a large undertaking. In order that it might be best accomplished President Hill says "it became necessary for the men interested to act together in a large and permanent manner through the medium of a corporation." At this time the purchase of the Great Northern Co. by the new corporation was neither suggested nor contemplated.

For some years President Hill and others who were interested in the great Northern Co., not including J. P. Morgan & Co., had in

Michigan Law Review, 1 Vol. 251.

Legal News, March 25, 1901.

contemplation the formation of a corporation for the purchase of their interests in that company with the general object that the interests should be held together. It was their desire to make the Great Northern Co's. policy of development a steady and continuous one. About August 1st. 1901, as this plan was approaching maturity those parties decided to sell to the new company, being formed by J. P. Morgan & Co. their interests in the Northern Pacific Co., which was considerable in amount, and to urge that the capital should be made sufficiently large to enable the holding corporations to acquire all of the shares of the Great Northern Co. as well as the Northern Pacific Co. that it deemed advisable to acquire. President Hill recommended and advised that all his friends sell their Northern Pacific stock to the new corporation when formed. As the Oregon Short Line, the purchasing agent of all of the Northern Pacific stock owned by the Union Pacific refused to sell out to the new company, [#] J. P. Morgan purchased their shares, paying them partly in cash and partly in the shares of the new company. The new stock paid to them was of sufficient amount to represent about 23% of the total capitalization.

This new company known as the Northern security Company was incorporated November 13th. 1901. ~~It~~ It was incorporated under the state laws of New Jersey with a paid up capital of \$30,000 and an authorized capital of \$400,000,000 or about \$122,000,000 in excess of the total capital stock of the two roads to be acquired. This stock was not to be offered to the public. It was merely to be exchanged for the shares of the Northern Pacific and Great Northern

#Journal of Com. and Com. Bulletin, Mar. 21. 1903.

##Michigan Law Review. Vol. 1 251.

railways.

Thus it was that, whereas previous to the organization of the Northern Security Co., a community of interests had existed between the two roads, part of the shares in each company being held by the owners in the other company. There was now a complete merger of interests. The Northern Security Co. was to own, vote and control the majority stock of each company. It was, however, not an owner but merely a custodian, according to the decision of the United States Supreme Court, of the shares of the two companies and being as such, a restraint of trade it could have no legal existence.

ROCK ISLAND COMPANY.-

While the work of the promoters in the Rock Island Company differs from that of the promoter in not being undone by the Supreme Court it also differs widely in method.

#At the beginning of the latter half of the nineteenth century the Rock Island Railroad consisted of a project existing only in the minds of its builders. A little later it consisted of 185 miles of poorly constructed, ill equipped track between Chicago and the town on the Mississippi whose name it bears. Across this river was a new and at that time undeveloped country, a territory of boundless resources and almost inexhaustible fertility. Into this territory the Rock Island began to penetrate, and from a weak line, paying its dividends with difficulty, by the end of the century it had grown into a system of over 4,000 miles, and paying dividends equalled by few other roads in the country.

Its rapid growth was due to two factors, its location and its management. It had as its Eastern terminal, one of the greatest market centers of the world, the railway metropolis of the West. From this, the greatest of all railroad centers, it extended into and through the richest grain regions of the continent. From Chicago westward it had but one line until it crossed the Mississippi. From there its lines radiated out through the great states of Iowa, Missouri, Tennessee, Texas, Kansas, Colorado, Nebraska, and Minnesota. Its increase in mileage had been steady and conservative. At this stage in its growth came the formation of the Steel Trust. Judge Moore and a party of his
#Railway Age, June 30, 1902.

friends were large holders of stocks in many of the subsidiary companies included in that enterprise. Having disposed of their interests in the steel trade they were seeking a new investment for their capital. They found in the Rock Island Ry. a situation offering unlimited possibilities, commanding as it did the traffic of a fertile section of country whose resources as yet had hardly begun to be developed. #Immediately Judge Moore organized a syndicate, which going into the open market purchased a controlling interest in this Railroad. The capital stock at this time was \$50,000,000. and the shares whose par value was \$100 were quoted at \$130. Therefore a controlling interest could have cost them no less than \$32,500,000. In June the capital stock was increased to \$75,000,000. This new stock being distributed to the share holders at par represented an additional investment on the part of the Moore syndicate of \$12,500,000. They now had invested an aggregate of \$45,000,000 in a property whose capital stock was \$75,000,000.

Under their influence the road began to pursue to a greater extent than before a policy of expansion. ##In the spring of 1902 the Rock Island System secured control of the Chocotaw, Oklahoma and Gulf Ry. 1655 miles in length; the Burlington Cedar Rapids and Northern, 1287 miles in length; the Rock Island and Peoria, 119 miles in length; and the St. Louis, Kansas City and Colorado, 105 miles. ###The system was now 7300 miles in length and the bond issue had reached the sum of \$95,000,000 on the main line.

#Railway Age, June, 30 1902.
##Com. and Fin. Chronicle 33 Vol. 732.
" " " " 32 " 732.

The Moore syndicate, while at this time desiring to retain control of the property, yet desired to withdraw a portion of their invested capital. In other words as a writer in the "Railway Age" expresses it: "They desired to eat their cake and yet have it." They began seeking a means by which this end might be accomplished. Obviously the most direct way for them to do was to replace a portion of the stocks with bonds, thus severing the owning from the controlling power. Already, however, the bonds represented 56% of the capital of the property, a much greater bond issue would most likely prove unsatisfactory, even in the face of the great earning power of the company. Besides the syndicate had a more ambitious policy in view than merely separating the voting power from the owning power.

In the view of the large percentage of bonds outstanding, in order to carry out the plan which they had determined upon, the first move was not to increase any of the bonds, but to increase the capital stock. The method whereby they made it possible to retain their control even with a much smaller investment while at the same time the total capitalization was more than doubled, must ever stand as the work of a financial genius.

The plan adopted was that of a holding company. The official name of the Rock Island System was the Chicago, Rock Island and Pacific Railway Company. On July 31st, 1902 the Chicago Rock Island and Pacific Railroad Company was incorporated in Iowa for the purpose of acquiring the property of the Railway Company.

[#]Railway Age, June 30 1902.

^{##}" " " "

^{###}Com. and Fin. Chronicle. 75 Vol. 1157.

Its capital stock was fixed at \$125,000,000.

On the same date the Rock Island Co. of New Jersey was incorporated, its authorized capital stock being \$150,000,000. Wm. T. Rankin was the president of both companies. No sooner had the Rock Island Co. been formed than it proceeded to get possession of all of the Chicago, Rock Island and Pacific Railroad bonds. #Then with its own stock, and the bonds of the acquired company, it proceeded to get possession of the securities of the Chicago, Rock Island and Pacific Railway Company on the following terms: For each share, of par value \$100, of the Railway Co. it paid \$100 in 4% gold bonds of the Railroad Co., \$70 in preferred stock of the Rock Island Co. and \$100 in common stock of the Rock Island Co. The stock to be exchanged was to be deposited with the Central Trust Co. before Sept. 1st 1902 and the new bonds issued November 1st. In this manner the Rock Island Co. secured about \$69,000,000 out of the Railway Co's. Total capitalization of \$75,000,000. ##The shares purchased were selling at about \$185 a share on the open market; the new securities immediately settled down to a market value of \$90 for the bonds, \$70 for the preferred stock and \$40 for the common stock. Thus for each \$185 in stocks the holders received about \$180 in stocks and bonds of the new company. The Rock Island Co. had left, after paying for the securities purchased, about \$5,000,000 of its preferred and \$30,000,000 of its common stock.

###The Rock Island was now burdened with the following securities. The \$95,000,000 in bonds, issued largely for the pur-

#Com. and Fin. Chronicle. Sept. 7, 1902.

#- " " "

###Railway Age, June 30, 1902.

pose of acquiring the subsidiary companies, came first in the priority of claims for interest. After them, comes the \$75,000,000 capital stock of the Railway Co. This capital while yet outstanding is virtually cancelled, being covered by the stocks and bonds of the new companies. This is true also of the capital stock of the Railroad Co. After the outstanding bonds the next security upon which interest must be paid are the \$75,000,000 bonds issued by the Railroad Company; and after them the \$54,000,000 preferred and the \$96,000,000 common stock of the Rock Island Company.

That the Moore syndicate was thus able to raise the capital stock from \$75,000,000 to \$150,000,000 was due to the extraordinary earning power of the property. #In 1900 the earning power was sufficient to pay 11 3/8% on \$50,000,000 capital stock and in 1902, 11% on \$75,000,000 capital stock. In the former of the two years just mentioned the reported surplus, after paying for increased equipments, improvements and maintenance, was \$5,000,000. The latter year it was \$7,500,000. To pay 4% on the \$75,000,000 of bonds issued requires \$3,000,000. Thus in the year 1900, 36% of the net income and in 1902, 29% would have been sufficient to have paid the interest on the bonds. During those two years it would have paid 3.7% and 7.5% on the preferred stock allowing nothing on the common stock.

Since we have seen how the increase of the capital was brought about in a manner entirely consistent with sound financing we are now ready to see how the control of the property was narrowed in the process. As has been previously stated the

#Railway Age, 34 Vol. 103.

##Com. and Fin. Chronicle. (Investors supplement)

the holding company's capital stock is divided into \$54,000,000 non cumulative, preferred stock and \$96,000,000 common stock.

#One of the peculiarities that marks the preferred stock is that it is to bear dividends at the rate of 4% until 1909, 5% until 1916, and thereafter 6%. For our purpose this is not its chief characteristic. By the provisions of the charter the affairs of the company are managed by a board of directors consisting of five classes. The first class is always and under all circumstances, to be a majority of the entire number. This class is to be elected by the preferred stock holders and the other four classes by the common stock holders. Through this provision a majority of the preferred stock holders by acting as a unit can at all times make themselves dominant in the management of the company's affairs. Thus by retaining a majority of the preferred stock, (less than \$30,000,000 in value) the Moore syndicate controls one of the largest railway properties in the world, as this system also controls the Frisco System. This acquisition took place in 1903.

#After obtaining possession of the Rock Island System the holding company had left about \$29,000,000 common stocks. The Frisco System, a railroad radiating out from St. Louis to the south and west, had a capital stock of about \$100,000,000 divided into \$5,000,000. 1st preferred, \$31,000,000 2nd preferred, and \$64,000,000 common.

#Articles of Incorporation.
 #Railway Age. June 30 1902.
 # " " 35 Vol. 354.



In January 1903 numerous rumors became current that the Rock Island Company was shortly to acquire the Frisco System. ~~##~~On May, 11th, 1903 this merger became a fact, the Rock Island Co. securing possession of it through the control of its common stock.

~~##~~It is believed that J. P. Morgan and Co. were the large holders of the Frisco Company stock who sold out to the Rock Island. At any rate the merger was negotiated through that firm.

The Rock Island gave in exchange for each share of Frisco common par value \$60, \$60 per value of the Chicago, Rock Island and Pacific Railroad Co's. gold bonds and an equal amount of its own common stock. In order to do this it was necessary for the Railroad Co. to increase their capital stock by \$20,000,000 and issue \$18,500,000 5% gold bonds. These bonds and stocks were acquired by the Rock Island Co. and used by them in the Frisco deal. ~~##~~The market value of the Frisco stock was about \$78 a share (May 15). The Rock Island stock at \$42 and the bonds at \$85; therefore their exchange was at about their respective market values.

The combined mileage of the two lines is 14,300 miles; the value of the property, estimating it at \$35,000 a mile, about a half a billion dollars. To so combine interests of such enormous magnitude, in such a way as to make possible their control by as small a sum as \$29,000,000 is a piece of work possibly ^{not} parallel by any other promoter.

~~##~~Railway Age. 35 Vol. 354.

~~##~~Current Stock Quotations.

CHAPTER 3

Conclusion.

An analysis of the promotion of the foregoing companies must show that the promoter is not carrying on a work of philanthropy. It is true that the results reaped by him in the way of financial returns are not always what he expects. This, however, only emphasizes the fact that his work is not unattended with risks. In spite of his occasional failures the fact remains that the impelling cause of his work is the desire for profit. This profit may be immediate or it may come only in the future. That depends largely on whether the promoter's connection with the enterprise is to be permanent or not. In the example of the Consolidated Tobacco and the Rock Island Railroad Companies where the work of promotion was done through men who expected to retain a permanent interest in the property no immediate large financial gains accrued to them. In most of the other examples the work of the promoter was undertaken in anticipation of an immediate reward.

That his work, especially in the later class of examples, must have an appreciative influence on our industries cannot well be doubted. There is, and must be, certain causes both enticing and compelling in many industries which make the work of the promoter possible. In some cases, as has been pointed out in the special examples studied it is the evils of competition. In the United States Steel Corporation it was a case of threatened war which promised the ruin of a great many companies in one of our largest and best developed industries. In other cases it is not the condition inherent in the business. It is the personal appeal of the

of the promoter to the manufacturer to go into the trust, ostensibly on the ground of the savings due to large combinations, but in reality in the hope of monopolistic prices for the manufactured product added to the even more potent argument, the offer on the part of the promoter to buy his plant at a price considerably in advance of its market value. This was evidenced in the case of the International Mercantile Marine Co. That company was organized during a very prosperous period of the shipping industry. When many of the holders of shares in the White Star Line were in doubt as to the advantages of selling to the proprietary company the managers of the White Star Line expressly pointed out to them that they were receiving a price far in excess of that which they had a right to expect. A similar state of affairs existed in the promotion of the Shipbuilding Co.

From the evidence obtained it would seem that in many cases economic considerations or reasons are not the chief ones for the promotion of an enterprise.

The causes directly responsible for their promotion are also responsible for their magnitude. Primarily, as we have said the promoter is working for profits. His profits, in most of the cases studied, are made through the retention by himself of a certain portion of the securities of the company which he organizes. The larger the stock issue the public can be persuaded to take at a fair price the greater becomes his own profits. It is essential that after the cost of the property acquired has been paid and the cost of the promotion fully satisfied through the sale of the securities that public faith in the enterprise is manifest enough for

them to buy even more stocks, the stocks which represent the promoters profits. The larger the promoter makes the enterprise and the more inclusive it sounds to the average investor the better he can juggle with the amount of securities to be marketed. In every case mentioned in the latter class the nominal value given to the

Over securities were made far in excess of the value Capitalization. of the property represented. In the case of the Mercantile Marine Co. the real cost of the property was about \$54,000,000. On the basis of this property \$170,000,000 worth of securities were placed on the market. In the case of the United States Shipbuilding Co. the property was not worth \$12,000,000 but furnished a basis for the issuing of \$70,000,000 in stocks and bonds. \$18,000,000 is considered a liberal estimate of the value of the property of the Tin Plate Co. It issued \$44,000,000 in stocks. While in the United States Steel Corporation one thoroughly versed with its affairs would not value its property at over one half its total capitalization which is \$1,400,000,000. It is not to be understood, however, that the promoter realized as profit the difference between the nominal value of the securities and the real value of the property plus the cost of promotion. In most cases the par value of the securities were far in excess of their market value. Most of the bonds, since they were in only one instance, issued in excess of the real value of the property, sold approximately near their par value. The preferred stock was usually fixed at an amount which the promoter thought likely the income of the business would be sufficient to pay dividends on. After that came the common stock. Although there has been hardly a single case in the latter division

where dividends have been paid for any time on the common stock; yet at the time of the formation of the various companies, matters were always put in such a light that it seemed entirely reasonable and likely that the common stock would be a dividend paying stock. Since it is out of the last class of stocks the promoter looks to a great extent for his profits the more plausible that he can make it appear that it is a good investment the better for himself.

The Tin Plate Co. has never paid any dividend on its common stock, the represented no real value, yet it is thought that Judge Promoter's Moore was able to dispose of 100,000 shares which he

Profits. retained at about \$44 a share, thus receiving about \$4,400,000 for his work of organization. # It is estimated that Mr. Morgan's profits in the formation of the Mercantile Marine Co. approximated \$1,450,000. According to the plans arranged by the promoters of the United States Shipbuilding Co. the promoters profits in that company were to exceed \$6,000,000. Judge Moore, however, maintained that the promoters profits are not excessive. "He undertakes an enterprise the successful issue of which is open to doubt. He requires large sums of money to invest in his enterprises; money which is not really secured because of the very nature of the work. The factory owners are hard to talk into a reasonable frame of mind in regard to the sale of their plants. The public reception of the new securities are always a matter of uneasiness to him." It is this last phase of the promoter's work which gives rise to the under writing syndicate. The underwriting syndicate was not used by Judge Moore in the Tin Plate Co. As had been previously explained

Report of Ind. Com. 1 Vol. 959-63.

The Underwriting Syndicate. he secured a cash option on the property needed, set a date on which it was to be received, and then proceeded with the organization of the company, in the mean^while getting most of the sellers to agree to accept stocks in the new company instead of cash. At the appointed time the securities and other evidences of ownership in the property purchased were exchanged for the cash and stocks of the new company. In that manner a large share of the stocks of the new company passed into the hands of the original owners of the property and the public were appealed to to only a limited extent to become purchasers.

The task of finding a sale for the securities of the new company was accomplished by J. P. Morgan, as well as by Mr. Young, through the agency of the underwriting syndicate. As soon as Mr. Morgan undertook the work of promotion he organized a syndicate which agreed to purchase, if necessary, a certain amount of the securities to be issued. For these securities it assumed the task of finding a market. Much of the promoters profits may come through his connection with the syndicate. In the United States Steel Corporation, Mr. Morgan's profits came exclusively through that source. The underwriters profits were distinct from the promoters in the Mercantile Marine Co. yet the underwriting syndicate played a very important part in the promotion.

The weakness of the underwriting syndicate in the Shipbuilding Co. was one of the chief causes for that company finding itself in the hands of a receiver at such an early date after its organization. The underwriting syndicate gets its profits through offering to take, and if necessary, taking the securities of the company at a figure which will leave them a good margin of profit after disposing of the securities to the public. In most cases their profits are large. The syndicate in the Steel Co., although investing only \$12,500,000 made a profit of \$50,000,000, the International Mercantile Marine underwriting syndicate made a profit of something like \$10,000,000, however in the Shipbuilding Co. the syndicate lost quite heavily.

#A method of inducing the public to buy these stocks which is somewhat more questionable than that of the underwriting syndicate is the use of bonuses. To what extent this means is employed cannot be definitely ascertained. Its main feature consists in giving to prominent financiers, or other men commanding the confidence of the public shares of the stocks in order to gain their influence. If the general public thinks the stocks and bonds worthy of investment by such men they too will invest in them.

The Rock Island Railroad, the Consolidated Tobacco Co. and the Northern Security Company, were promoted by men inside of the business. The promoters were either men inside and interested in it from a purely mercantile point of view, or men who come into the business with a view of consolidating its various elements into one strong unified body in which they would be the dominant force. This latter case #Jenk's Trust Problem.

is well represented by the Rock Island Company, while the former is well represented by the Consolidation of the Tobacco Co. These cases present many points in contrast with the preceding class of cases. The capitalization is by no means so great in proportion to the actual earnings power of the company. As a consequence their securities, other things being equal, have not reached so low a price in the market as the following table will show.

| Company. | Preferred. | Common. |
|---|------------|-----------|
| United States Steel. | 52 | 8 5/8 |
| International Mercantile. | 17 | 5 |
| Tin Plate Co. (previous to its acquisition by the Steel Trust) | 35 | 18 |
| United States Shipbuilding Co. | No value. | No value. |
| Consolidated Tobacco. | | 110 |
| Rock Island Co. | 65 | 20 3/4 |
| Northern Securities. (declared illegal by United States Supreme Court.) | | |

A striking difference further noted is that in the Rock Island Co. and the Tobacco Co. no cumulative stock was provided for while in the other instances a large amount of cumulative stock was provided.

In the last two cases the effect of the consolidation has not been this far to affect their stability. The object of the promoter was the securing control of the property. That there is an element of danger in placing such large interests in the hands of so few men cannot be doubted; but a discussion of that is outside the limits of this article.

After the disclosures made in the organization of the Shipbuilding Co. there is no need to state that the promoter has

received altogether too little supervision at the hands of the law.

Legal He is permitted to purchase valuable properties, or
Supervision. properties of but little value, with them as a basis,

 capitalize a company at any amount that he may
choose; and offer its securities to the public as a good investment. Important facts may be concealed from the latter and even many erroneous statements made, as in the prospectus issued by Young in the promotion of the Shipbuilding Co. Under the laws of New Jersey, as enforced, under which all of the companies were incorporated the promoter is neither compelled to state the true value of the property, nor the condition under which the stock is issued. The report of the Industrial Commission for 1900 recognizing this fact and the evil results arising therefrom has made the following recommendations:

(a) "That the promoters and organizers of companies or industrial combinations which look to the public to purchase, or deal in their stocks or securities should be required to furnish with details regarding the organization, the property or services for which stocks or securities are issued amount and kind of same, and all other material information for safe and intelligent investment;

(b) That any prospectus or announcement of any kind soliciting subscriptions which fails to make full disclosures as aforesaid, or which is false, should be deemed fraudulent and the promoters, with their associates held legally responsible.

In the New York Companies Act the following section are to be found in the connection with the promotion of corporations.

"Every share of stock shall be deemed to be issued and shall be held subject to the payment of its par value in cash, and before the issuance of said stocks a contract shall be filed in the registered office of the company which shall truly and fully disclose in detail the considerations for which the said stock is issued, whether the same is the property, service or otherwise".

This Act further promised that every prospectus or matter of any form, issued with the end in view of inducing subscriptions must contain among other things the names of the promoters and underwriters, their rewards, bonuses and the remuneration for their services; the names of all parties entering directly, or indirectly into contracts in regard to the promotion; the property purchased or acquired; from whom, the exact considerations paid, or to be paid for it, as well as a description of the property.

Should such provisions have prevailed on our statute books, and have been properly enforced, as the ones just enumerated it is altogether likely that the capitalization of most of the corporations just studied would be represented by an amount small in comparison with their present capitalization.

Less strongly too would have been the tendency away from purely industrial principles into speculative fields. Under the existing laws the tendency of the promoter is to unite a certain group of interests regardless of the economic advantages in so doing. As James B. Dill expressed it, "He was not working on the corporate problem to demonstrate an economic proposition from the standpoint of economics". Rather he was looking for a more tangible return for



his efforts. It mattered but little to him if he plunged an industrial field into a speculative one. Purely industrial and mercantile principles were lost sight of in the desire for immediate profit. This has been demonstrated not only by the over capitalization of the corporations; but also the large issue of the preferred cumulative stock which took away from the directors their power to conduct the business on conservative lines. There are but few classes of business where the earnings remain uniformly constant. They vary continually. In many instances a number of years may follow each other during which the income is hardly sufficient to meet the costs of operations and repairs. To tide over such an emergency a large surplus is almost a necessity. By providing for a cumulative stock whereby the company is not able to accumulate a surplus; but must continue, even during those years when no earnings are being made to look forward to their prosperous years the business is rendered unstable. This thing is not often done by a conservative body of business men engaged primarily in a business enterprise. It represents the means taken by the promoter to increase the sale of the securities which he wishes to market; since if an investor thinks that he is sure of 7% annually on his investment he is more likely to buy than if no cumulative provision was not made.

A brief summary of the work of the promoter thus far would seem to indicate that his work is carried on in the most cases for temporary profit, and that he has taken many businesses
 Summary. which were purely a field for investment and thrown them into the field of speculation. He has not been properly held responsible by our laws, to the end that the public has bought from

him large quantities of securities of no real value whatever. His profits, in most cases, have been out of proportion to the work accomplished. In some cases his attitude toward the public has been one of deception and fraud. Unless he is more wisely curbed and restrained by intelligent legislation he is not likely to remain long a respected factor in our industrial world. Rather he is likely to become relegated to the class of purely industrial speculators where so many of that type now properly belong.

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